

DW 05-072

PENNICHUCK EAST UTILITIES, INC.

Petition for Permanent and Temporary Rate Increases

Order Approving Settlement Agreement

ORDER NO. 24,591

February 24, 2006

APPEARANCES: McLane, Graf, Raulerson & Middleton, P.A. by Sarah B. Knowlton, Esq. for Pennichuck East Utility, Inc.; Office of the Consumer Advocate by F. Anne Ross, Esq. on behalf of residential ratepayers; and Marcia A. B. Thunberg, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

Pennichuck East Utility, Inc. (PEU) provides water service to approximately 4,949 customers located in limited areas of the towns of Litchfield, Londonderry, Windham, Pelham, Atkinson, Sandown, Derry, Raymond, Plaistow, Hooksett, Bow, and Lee. On April 8, 2005, PEU filed with the Commission a Notice of Intent to File Rate Schedules.

On May 20, 2005, PEU filed rate schedules proposing to increase revenues in the amount of \$779,027, or 24.99%. Contemporaneously, PEU filed for a temporary rate increase, effective for service rendered on and after June 1, 2005, to increase revenues by \$381,565, or 12.25%. Also on May 20, 2005, PEU requested waiver of certain provisions of Puc 1604.01(a) averring that such information was duplicative of what was already on file with the Commission. On June 7, 2005, Staff filed a concurrence with PEU's waiver request. The Commission later granted the waiver request on September 8, 2005, by secretarial letter.

On June 16, 2005, the Commission issued Order No. 24,476, suspending the proposed tariffs pending investigation and decision thereon; scheduling a prehearing conference for July 6, 2005, to address procedural matters regarding the proposed temporary and permanent

rate increases; and ordered PEU to publish notice of the hearing. PEU noticed the hearing through publication of Order No. 24,476 on June 20, 2005. On June 21, 2005, the Office of the Consumer Advocate (OCA) filed a notice of its intent to participate in this docket.

Staff and the parties held a technical session after the pre-hearing conference and agreed upon a proposed procedural schedule for submission to the Commission. On July 8, 2005, the Commission approved the procedural schedule by secretarial letter.

On August 9, 2005, the Commission held a hearing on temporary rates, at which PEU, OCA, and Staff presented an agreement on temporary rates. PEU, OCA, and Staff proposed a temporary rate increase in the amount of 9%, applied equally to PEU's three rate groups, effective June 16, 2005, on a service rendered basis. On August 12, 2005, PEU filed with the Commission, Exhibit 4, its response to a record request made at hearing for a schedule depicting PEU's *pro forma* test year rate of return under the terms of the proposed temporary rate increase. On September 9, 2005, the Commission issued Order No. 24,513, approving the settlement agreement regarding temporary rates.

Staff and the parties conducted discovery pursuant to the procedural schedule and on January 6, 2006, Staff and the parties filed a Settlement Agreement with the Commission in anticipation of the hearing set for January 12, 2006. The hearing was conducted as scheduled, at which PEU, OCA and the Staff supported the Settlement Agreement.

On February 16, 2006, Staff filed with the Commission its recommendation on rate case expenses as well as a copy of PEU's final accounting of rate case expenses. Staff determined that \$1,481.50 of the expenses should be disallowed because they were deemed to be related to the Commission Staff's audit of PEU's books and records. Staff stated that the Commission traditionally does not allow recovery of audit-related costs in rate case expenses.

Accounting for this deduction, Staff recommended the Commission approve PEU's recovery of \$68,447.98 in rate case expenses and stated this would result in a monthly surcharge of \$1.15 per customer for 12 months.

II. SETTLEMENT AGREEMENT

Staff, PEU, and the OCA's positions are set forth in the Settlement Agreement, which is summarized below.

A. Revenue Requirement

Staff and the parties recommend the Commission grant PEU a 24.26% overall increase in revenues, based on a test year net operating income requirement of \$761,796, to produce a revenue requirement of \$3,871,953. Staff and the parties stipulated that this proposed net operating income requirement and resulting revenue requirement represent a reasonable compromise of all issues relating to the revenue requirement pending in this docket, including allowed overall rate of return, return on equity, *pro forma* adjustments, capital additions to PEU's rate base, operating expenses, temporary rates, and depreciation.

B. Consolidation of Rate Design

Staff and the parties recommend the Commission consolidate the three existing rate groups (A, B and L) into two rate groups (A and L). According to the Settlement Agreement, the only difference between rates A and L is that Rate L equals Rate A plus a surcharge for municipal fire protection. Rate A would be applied to all metered customers other than Litchfield; Litchfield would receive Rate L. Exh. 11. At hearing, PEU explained that at Rate A, a 5/8 inch metered customer would incur a monthly standard customer charge of \$15.58, plus a volumetric charge of \$4.75 per 100 cubic feet. At hearing, PEU explained that the municipal fire protection surcharge is presently embedded in Litchfield customer rates but pursuant to the

Settlement Agreement, the fire protection component would be shown separately on Rate L customer bills. Hearing Transcript of January 12, 2006 (1/12/06 Tr.) at 25, lines 3-6. That fire protection surcharge would be \$108.12 per customer on an annual basis. Exh. 7 at 6 and 1/12/06 Tr. at 40 lines 22-24. PEU emphasized that Rate A does not have a surcharge because fire protection is paid for separately or is paid for by the municipalities.

The proposed 24.26% overall increase in revenues would increase an average residential customer's annual water bill as follows: by 44.8% for the present Rate A customers; 11.3% for the present Rate B customers; and 38.7% for the present Rate L customers. The Settlement Agreement originally estimated that Rate L customers would see a 34.6% rate increase but this calculation was corrected at hearing. 1/12/06 Tr. at 41 lines 2-4.

Staff and the parties aver that there is no longer a cost basis for retaining the existing rate groups. At hearing, Staff testified that in Docket No. DR 89-224, Southern New Hampshire Water Company, Inc., the owner of the water systems at the time, proposed to consolidate the rates and that the Commission gradually moved in that direction by establishing Rates A, B, and L. 1/12/06 Tr. at 31 lines 19-24 and at 32 lines 1-3. Staff and the parties also averred that the differing effective rate increases per rate group were justified because they are reflective of the level of investment PEU has made in water systems within each rate group since assuming ownership in 1998. On a per-customer basis, that level of investment is as follows: for Rate A, \$2,208.68; for Rate B, \$858.72; and for Rate L, \$1,182.75.

C. Temporary Rate Recoupment

Staff and the parties agree that permanent rates shall be effective for service rendered on and after June 16, 2005, consistent with the Commission's Order No. 24,513 on temporary rates. Staff and the parties recommend the Commission allow PEU to recover the

difference between what PEU collected under temporary rates since June 16, 2005, and what it would have collected under permanent rates since June 16, 2005, over a 12-month period. Staff and the parties agree and recommend to the Commission that, due to the complexity of reconciling temporary rates by rate group, where the three previous rate groups have been reduced to two in the Settlement Agreement, PEU shall calculate a total of dollars to be recovered from customers in each of the prior rate groups, by type of customer (e.g. residential and commercial/industrial), and then recover those dollars on an equal basis from all customers in those classes. At hearing, PEU presented Exhibit 14, which identifies the recoupment to be collected as a surcharge per customer class per month for 12 months as follows: \$5.15 for residential customers; \$16.83 for commercial/municipal customers; \$6.15 for private fire protection; \$17.89 for private hydrants; and \$123.85 for municipal fire protection and hydrants. PEU testified that the total temporary rate recoupment is approximately \$359,000. 1/12/06 Tr. at 59 line 4. PEU testified that it used estimated revenues for January and February 2006 and that actual recoupment will be based on actual revenue figures for those months. 1/12/06 Tr. at 56 lines 13-21. PEU plans to submit the actual figures to Staff for its review and audit prior to billing the recoupment. 1/12/06 Tr. at 57 lines 1-6.

D. Rate Case Expense Surcharge

Staff and the parties recommend the Commission allow PEU to recoup its rate case expenses and the costs associated with the depreciation study through a surcharge applied over a 12-month period. Staff and the parties recommend that rate case expenses include PEU's legal expenses, administrative expenses such as copying and delivery charges associated with filing the case, and depreciation study expenses. At hearing, PEU estimated its rate case expenses to be \$69,500, including \$39,600 for the depreciation study. 1/12/06 Tr. at 59 lines 22-

23 and at 61 line 7. On February 16, 2006, Staff submitted its rate case expense recommendation to the Commission. Staff stated that it had reviewed PEU's rate case expenses and found them reasonable, with the exception of \$1,481.50 which it concluded was for expenses from PEU's legal counsel related to Staff's audit. Staff recommended the Commission disallow this amount, as the Commission customarily excludes audit-related expenses from rate case expense recovery. Staff recommended that the Commission approve recovery of \$68,447.98 in rate case expenses in a surcharge in the amount of \$1.15 per customer per month for a period of 12 months.

E. Cost of Service Study

Staff and the parties agreed that PEU should complete a Cost of Service Study prior to its next rate filing. At hearing, PEU explained that the Cost of Service Study will allow PEU to confirm that the allocation of costs to fire protection is accurate. 1/12/06 Tr. at 71 lines 1-23. Presently, PEU allocates costs to fire protection within standard industry ratios. *Id.*

F. Depreciation Study

As noted earlier, PEU conducted a Depreciation Study. The revenue requirement impacts of that study are contained in the revenue requirement recommended by Staff and the parties, as detailed above. In addition, Staff and the parties recommend the Commission allow PEU to book the following, as indicated in Attachment 1 to the Settlement Agreement: total depreciation expense of \$636,068; amortization of reserve imbalance of \$64,417; amortization of plant acquisition adjustment of \$(238,268); and amortization of CIAC of \$(79,826). Staff and the parties also recommend that the Commission approve the revised depreciation accrual rates for certain plant accounts as identified in Attachment 1.

IV. COMMISSION ANALYSIS

New Hampshire RSA 378:7 authorizes the Commission to fix rates pursuant to an order after a hearing. In determining just and reasonable rates, the PUC must balance the consumers' interest in paying no higher rates than are required with the investors' interest in obtaining a reasonable return on their investment. *Eastman Sewer Company, Inc.*, 138 N.H. 221, 225 (1994). In circumstances where a utility seeks to increase rates, the utility bears the burden of proving the necessity of the increase pursuant to RSA 378:8.

We first consider the revenue requirement proposed by Staff and the parties. Staff and the parties propose a net operating income requirement of \$761,796 and a revenue requirement of \$3,871,953. This is an increase of 24.26% over PEU's test year revenues. PEU, which has not had a rate increase since it acquired the water system in 1997, had initially sought a 29.61% increase.¹

The revenue requirement represents a settlement between Staff and PEU of all issues related to the revenue requirement, including allowed overall rate of return, return on equity, capital structure, *pro forma* adjustments, capital additions to rate base, operating expenses, depreciation issues, and temporary rates. The revenue requirement is based on investments prudently incurred and used and useful in the provision of utility service. We find the resulting revenue requirement is just and reasonable and we will approve the depreciation accrual rates, depreciation expense, and amortizations identified in Attachment 1 to the Settlement Agreement.

¹At hearing, Staff testified that although PEU's original filing reflected a 24.99% rate increase, that request did not include the results of PEU's updated depreciation study. Based on the updated depreciation study, PEU's total revenue requirement increase request in this docket was 29.61%. 1/12/06 Tr. at 30 line 9.

We next consider Staff and the parties' recommendation to consolidate PEU's three rate groups in to two. By way of background, the structure of the three rate groups was established by the Commission in *Southern New Hampshire Water Company* (Southern), in Docket No. DR 89-224, 76 NH PUC 381 (1991). Consumers Water Company, the parent of Southern, ultimately changed the name of the water utility to Consumers New Hampshire Water Company, Inc. (Consumers). See *Southern New Hampshire Water Company, Inc.*, 79 NH PUC 692 (1994). The three rate groups were established to mitigate significant subsidization resulting from Southern's purchase of smaller, less efficient, water systems. At the time, the Commission concluded that "[T]he benefits of the policy (of encouraging larger systems to rescue smaller distressed systems) would be short-lived if existing customers are asked to pay substantial subsidies to rescue the customers of the smaller systems." See *Consumers New Hampshire Water Company, Inc.*, 81 NH PUC 410, 416 (1996), citing *Southern*, 76 NHPUC at 534. Consumers filed a rate case in 1995 and requested that the differential between the rate groups be reduced but the Commission affirmed retention of the three rate groups in the interest of promoting accurate price signals, economic efficiency, and minimizing the risk of inappropriate subsidies between groups of ratepayers. *Id.*

The character of the water system changed greatly in October 1997 when the Town of Hudson municipalized the portion of the water system located within the town boundaries. See *Consumers New Hampshire Water Company, Inc.*, 82 NH PUC 775 (1997). The Town of Hudson's purchase removed approximately 4,000 customers from the Consumers system. The remaining system comprised many satellite systems, which PEU purchased in November 1997. See *Consumers New Hampshire Water Company, Inc.*, 82 NH PUC 814 (1997). Staff and the parties aver that much of the rationale and cost basis for retaining the three

rate groups no longer exists, as the remaining satellite systems experience similar administrative and operation and maintenance costs. Exh. 7 at 5. We agree with Staff and the parties that cost-based reasons no longer exist to justify retention of the three rate groups. Accordingly, we find that consolidating the three rate groups is just and reasonable.

With respect to Rate L, we note that the Commission previously approved the methodology for recovering fire protection revenues through a customer surcharge on Litchfield customers, on an interim basis, until the Town of Litchfield assumed financial responsibility. In 1993, the Town of Litchfield voters were in the process of authorizing the town to assume financial responsibility for public fire protection; however, this vote never came to pass. See *Southern New Hampshire Water Company, Inc.*, 78 NH PUC 243 (1993). The Commission ultimately rescinded orders requiring the Town of Litchfield to assume financial responsibility for public fire protection since the town had demonstrated it had made all of its investments in fire protection equipment designed to fight fires from static sources of water rather than relying on pressurized municipal fire hydrants. *Southern New Hampshire Water Company, Inc.* 79 NH PUC 14 (1994). The unique nature of how the Town of Litchfield's public fire protection has evolved and the lack of any change in those circumstances persuade us that this surcharge methodology ought not to change.

We will revisit allocation of fire protection costs in PEU's next rate case, by which time, according to the Settlement Agreement, PEU will have completed a Cost of Service Study. That study will allow us to determine the accuracy of the present cost allocation formula for all of PEU's fire protection charges. We are satisfied that the fire protection surcharges, including Litchfield's fire protection surcharge, are within industry standards. Accordingly, we

reaffirm that the fire protection surcharge added to the consolidated rate to form Rate L for Litchfield customers is just and reasonable.

We now address the effective date and recoupment of the permanent rate increase. In Order No. 24,513 (September 9, 2005), the Commission authorized PEU to raise rates in all three rate groups by 9%, effective for service rendered on or after June 16, 2005, on a temporary rate basis. Staff and the parties propose a final permanent rate increase of 24.26%. PEU testified that it intends to recover the difference between the 9% temporary rate and 24.26% permanent rate, 15.26%, from customers in an equal amount over 12 months. 1/12/06 Tr. at 54 lines 1-3 and Exh. 7 at 7. RSA 378:29 requires that at the conclusion of the rate proceeding, the utility be allowed to amortize and recover the difference between the temporary rate and permanent rate for the period of time that temporary rates were in effect. We will make permanent rates effective as of the date of this order and thus will allow Pennichuck to recoup the difference from June 16, 2005 through the date of this order. We understand PEU will file a revised Exhibit 14 which will reflect actual recoupment figures and that Staff will review PEU's figures for accuracy. Based on the estimated figures, the proposed temporary rate recoupment surcharge and proposed 12-month recovery period appear to be just and reasonable. We instruct Staff to review revised Exhibit 14 when filed to ensure that the temporary rate surcharge is in compliance with this order.

Lastly, we address the proposed rate case expense surcharge. Staff and the parties recommend the Commission allow PEU to recover rate case expenses over a 12-month period and that allowable rate case expenses include PEU's legal expenses, administrative expenses, such as copying and delivery charges associated with filing the case, and depreciation study expenses. According to Staff's February 16, 2006 recommendation letter, PEU seeks to recover

a total of \$69,929.48 in rate case expenses, similar to what PEU estimated at hearing. Upon review of the rate case expenses, Staff concluded that \$1,481.50 for legal charges pertaining to audit related work should be excluded. Staff averred that the Commission customarily excludes audit related costs from rate case expense recovery and we agree. Response to audit requests is a continuing obligation of utilities under RSA 374:18 and is recognized in calculating the permanent rate in RSA 378:28. Since audit-related expenses are already recovered through the permanent rate, allowing these same expenses to be included as a surcharge for rate case expenses would in effect amount to double recovery of these expenses. We find that excluding \$1,481.50 from recovery through the rate case expense surcharge is reasonable. Lastly, Staff calculated that recovery of the \$68,447.98 from PEU's 4,949 customers over 12 months would result in a monthly surcharge of \$1.15 per customer. We find the amount to be just and reasonable and, therefore, approve a rate case surcharge in that amount.

Having reviewed the record in this proceeding, including the Settlement Agreement and supporting testimony presented at the January 12, 2006 hearing, we find the terms of the Settlement Agreement to be reasonable and in the public good. We find that the terms will result in just and reasonable rates and represent an appropriate balancing of ratepayer interests and the interests of PEU's investors under current economic circumstances.

Accordingly, we approve the Settlement Agreement.

Based upon the foregoing, it is hereby

ORDERED, the Settlement Agreement is approved as discussed herein; and it is

FURTHER ORDERED, that the proposed permanent rate increase is hereby approved for service rendered on or after the effective date of this order; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. is authorized to recover \$68,447.98 in rate case expenses in a surcharge to customer bills over 12 months as specified above; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. shall file with the Commission no later than 20 days after the date of this order a final accounting of its temporary rate recoupment; and it is

FURTHER ORDERED, that Pennichuck East Utility, Inc. file with the Commission a compliance tariff within ten days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this twenty-fourth day of February, 2006.

Thomas B. Getz
Chairman

Graham J. Morrison
Commissioner

Clifton C. Below
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary